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DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506-AA37

Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations – Requirement That Mutual Funds Report Suspicious Transactions

AGENCY: Financial Crimes Enforcement Network, Department of the Treasury.

ACTION: Final rule.

SUMMARY: This document amends the regulations implementing the statute generally known as the Bank Secrecy Act to require mutual funds to report suspicious transactions to the Financial Crimes Enforcement Network. The amendment constitutes a further step in the enhancement of the comprehensive system for the reporting of suspicious transactions by major categories of financial institutions operating in the United States, as a part of the Department of the Treasury's counter-money laundering program.

DATES: Effective Date: This final rule is effective [INSERT DATE THAT IS 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

Applicability Date: The requirements in this final rule apply to transactions occurring after [INSERT DATE THAT IS 180 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. *See* 31 CFR § 103.15(g) of the final rule contained in this document.

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949-2732.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Provisions

The Bank Secrecy Act¹ authorizes the Secretary of the Treasury (Secretary) to issue regulations requiring financial institutions to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, and regulatory matters, or in the conduct of intelligence or counter-intelligence activities, to protect against international terrorism, and to implement counter-money laundering programs and compliance procedures.² The Secretary's authority to administer the Bank Secrecy Act has been delegated to the Director of the Financial Crimes Enforcement Network. Our regulations implementing the Bank Secrecy Act are codified at 31 CFR Part 103.

With the enactment of 31 U.S.C. 5318(g) in 1992,³ Congress authorized the Secretary to require financial institutions to report suspicious transactions. As amended by the USA PATRIOT Act, subsection 5318(g)(1) states that:

The Secretary may require any financial institution, and any director, officer, employee, or agent of any financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation.

Subsection (g)(2)(A) provides further:

If a financial institution or any director, officer, employee, or agent of any financial institution, voluntarily or pursuant to this section or any other authority, reports a suspicious transaction to a government agency –

¹ Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314; 5316-5332.

² Language expanding the scope of the Bank Secrecy Act to intelligence or counter-intelligence activities to protect against international terrorism was added by section 358 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the USA PATRIOT Act), Public Law 107-56.

³ 31 U.S.C. 5318(g) was added to the Bank Secrecy Act by section 1517 of the Annunzio-Wylie Anti-Money Laundering Act, Title XV of the Housing and Community Development Act of 1992, Public Law 102-550; it was expanded by section 403 of the Money Laundering Suppression Act of Title IV of the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, to require designation of a single government recipient for reports of suspicious transactions.

(i) the financial institution, director, officer, employee, or agent may not notify any person involved in the transaction that the transaction has been reported; and

(ii) no officer or employee of the Federal Government or of any State, local, tribal, or territorial government within the United States, who has any knowledge that such report was made may disclose to any person involved in the transaction that the transaction has been reported, other than as necessary to fulfill the official duties of such officer or employee.

Subsection (g)(3)(A) provides that neither a financial institution, nor any director, officer, employee, or agent of any financial institution

That makes a voluntary disclosure of any possible violation of law or regulation to a government agency or makes a disclosure pursuant to this subsection or any other authority ... shall ... be liable to any person under any law or regulation of the United States or any constitution, law or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure.

Finally, subsection (g)(4) requires the Secretary, “to the extent practicable and appropriate,” to designate “a single officer or agency of the United States to whom such reports shall be made.”⁴ The designated agency is in turn responsible for referring any report of a suspicious transaction to “any appropriate law enforcement, supervisory agency, or U.S. intelligence agency for use in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”⁵

⁴ This designation does not preclude the authority of supervisory agencies to require financial institutions to submit other reports to the same agency or another agency “pursuant to any other applicable provision of law.” See 31 U.S.C. 5318(g)(4)(C).

⁵ See 31 U.S.C. 5318(g)(4)(B).

B. Mutual Fund Regulation and Money Laundering

This final rule applies to investment companies that are “mutual funds,” which are open-end management investment companies as described in the Investment Company Act of 1940 (15 U.S.C. 80a). Mutual funds are the predominant type of investment companies. As of September 2005, investors held approximately \$8.6 trillion in U.S. mutual fund shares, representing more than 95 percent of the assets held by investment companies regulated by the U.S. Securities and Exchange Commission (Commission).⁶ Currently, more than 2,400 active mutual funds are registered with the Commission.⁷

This final rule is part of a series of steps that we are taking to address comprehensively the risk of money laundering through mutual funds. In April 2002, we issued an interim final rule to implement section 352 of the USA PATRIOT Act. The interim final rule required mutual funds to develop and implement anti-money laundering programs designed to prevent them from being used to launder money or finance terrorist activities, which includes achieving and monitoring compliance with the applicable requirements of the Bank Secrecy Act and its implementing regulations.⁸ In May 2003, we issued, jointly with the Commission, a final rule to implement section 326 of the USA PATRIOT Act, requiring mutual funds to implement reasonable procedures to: (1) verify the identity of any person seeking to open an account, to the extent reasonable and

⁶ The staff of the Commission estimates, based on filings, that as of September 2005, approximately \$8.6 trillion was invested in U.S. mutual funds (including \$1 trillion invested in open-end management companies that fund variable life insurance and variable annuity contracts, and \$259 billion invested in open-end management companies that are exchange-traded funds).

⁷ Approximately 1,219 of these funds are “series companies” with an aggregate of 8,425 portfolios. A “series company” is a registered investment company that issues two or more classes or series of preferred or special stock, each of which is preferred over all other classes or series with respect to assets specifically allocated to that class or series. 17 CFR § 270.18f-2. The assets allocated to such a class or series are commonly known as a “portfolio.” The series or portfolios of a series company operate, for many purposes, as separate investment companies.

⁸ See 67 FR 21117 (Apr. 29, 2002).

practicable; (2) maintain records of the information used to verify the person's identity; and (3) determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to investment companies by any federal government agency and designated as such by the Department of the Treasury in consultation with federal functional regulators.⁹

This final rule follows other recent actions that expand the application of requirements that financial institutions report suspicious activity. Since April 1996, we have issued rules under the authority of 31 U.S.C. 5318(g) requiring banks, thrifts, and other banking organizations to report suspicious activity.¹⁰ In collaboration with us, the federal bank supervisory agencies concurrently issued suspicious activity reporting rules under their own authority, applying to banks, bank holding companies, and non-depository institution affiliates and subsidiaries of banks and bank holding companies.¹¹ Since the beginning of 2002, we have required certain money services businesses to report suspicious activity.¹² We adopted final rules for the reporting of suspicious activity applicable to brokers or dealers in securities in July 2002,¹³ to casinos and card

⁹ See 68 FR 25131 (May 9, 2003) text accompanying notes 116-117. Under the final rule, a mutual fund may contractually delegate the implementation and operation of its customer identification program to a service provider such as a transfer agent, although the mutual fund would continue to be responsible for compliance with applicable requirements.

¹⁰ See 31 CFR § 103.18 (requiring banks, thrifts, and other banking organizations to report suspicious transactions).

¹¹ See 12 CFR § 21.11 (issued by the Office of the Comptroller of the Currency); 12 CFR § 208.62 (issued by the Board of Governors of the Federal Reserve System); 12 CFR § 353.3 (issued by the Federal Deposit Insurance Corporation); 12 CFR § 563.180 (issued by the Office of Thrift Supervision); 12 CFR § 748.1 (issued by the National Credit Union Administration).

¹² See 31 CFR § 103.20 (requiring money transmitters and issuers, sellers, and redeemers of money orders and traveler's checks to report suspicious transactions).

¹³ See 67 FR 44048 (July 1, 2002). In 2003, broker-dealers filed 4,267 Suspicious Activity Reports, 5.7% of which (242 reports) involved money market funds and 6.3% of which (268 reports) involved other mutual funds. In the first six months of 2004, of 2,612 reports filed by broker-dealers, 5.3% (139 reports)

clubs in September 2002,¹⁴ to currency dealers and exchangers in February 2003,¹⁵ to futures commission merchants and introducing brokers in commodities in November 2003,¹⁶ and to insurance companies in November 2005.¹⁷ This final rule extends suspicious activity reporting to mutual funds. Suspicious activity reporting by mutual funds is expected to provide highly useful information in law enforcement and regulatory investigations and proceedings, as well as in the conduct of intelligence activities to protect against international terrorism.¹⁸

II. Notice of Proposed Rulemaking

On January 21, 2003, we published a Notice of Proposed Rulemaking (Proposed Rule), proposing an amendment to the regulations implementing the Bank Secrecy Act that would extend the requirement to report suspicious activity to mutual funds.¹⁹ The comment period for the Proposed Rule ended on March 24, 2003. We received five comment letters: three from trade associations, and one each from a regulatory advocacy group and an academic society at a university. These comments are discussed below in the Section-by-Section Analysis.

involved money market funds and 6.2% (162 reports) involved other mutual funds. FINANCIAL CRIMES ENFORCEMENT NETWORK, THE SAR ACTIVITY REVIEW – BY THE NUMBERS (Issue 3, Dec. 2004).

¹⁴ See 67 FR 60722 (Sept. 26, 2002).

¹⁵ See 68 FR 6613 (Feb. 10, 2003).

¹⁶ See 68 FR 65392 (Nov. 20, 2003).

¹⁷ See 70 FR 66761 (Nov. 3, 2005).

¹⁸ See 31 U.S.C. 5311 (stating purpose of the reporting authority under the Bank Secrecy Act).

¹⁹ See 68 FR 2716 (Jan. 21, 2003).

III. Section-by-Section Analysis

A. 103.15(a) – Reports by Mutual Funds of Suspicious Transactions

Section 103.15(a) sets forth the obligation of mutual funds to report suspicious transactions that are conducted or attempted by, at, or through a mutual fund and that involve or aggregate at least \$5,000 in funds or other assets.²⁰ The obligation to report a transaction under this rule and 31 U.S.C. 5318(g) applies whether or not the transaction involves currency.²¹ We are aware that the use of currency in mutual funds transactions is rare.

²⁰ A mutual fund is already obligated to report the receipt of cash (and certain cash-related instruments) totaling more than \$10,000 in one transaction or two or more related transactions. See 67 FR at 21119. 26 U.S.C. 6050I requires a person to report information about such transactions to the Internal Revenue Service; 31 U.S.C. 5331 requires a person to report information about similar transactions to us. One commenter expressed concern over some mutual funds or their transfer agents being required to file both a report under this final rule and a report under 26 U.S.C. 6050I (“Form 8300”) because they are considered to be “nonfinancial trades or businesses.” The commenter expressed concern about both duplication of reporting and conflicting disclosure provisions, because 26 CFR § 1.6050I-1(f) requires notifying the subject of a report that the amount of cash in the transaction(s) is being reported to the Internal Revenue Service, whereas section 103.15(d) of this final rule prohibits notifying the subject of a Suspicious Activity Report that the transaction has been reported. With regard to the concern over duplication of reporting, we note that the forms serve different purposes and are required under different circumstances. Form 8300 is designed to provide information about large cash (and certain non-cash instrument) transactions received by a business. The triggering factors are entirely objective. On the other hand, the Suspicious Activity Report is designed to provide information about transactions and activity that the reporting entity knows, suspects, or has reason to suspect may be a violation of law or regulation. The triggering factors for the Suspicious Activity Report are largely subjective. While it is possible that a particular transaction may trigger the filing of both forms, and while some of the information provided may overlap, the purposes for the filings and the ways in which the information will be used by law enforcement differ greatly. Furthermore, the filing of a Form 8300 does not presume the filing of a Suspicious Activity Report, and vice versa. Moreover, with regard to the concern over conflicting disclosure requirements, we note that there is nothing in the requirement for disclosure of the filing of a report under 26 U.S.C. 6050I that would require disclosure of the filing of a Suspicious Activity Report. In fact, a mutual fund is prohibited from intentionally or unintentionally disclosing the filing of a Suspicious Activity Report when it discloses the filing of a report of the receipt of cash or certain non-cash instruments, as required by 26 CFR § 1.6050I-1(f).

²¹ Many currency transactions are *not* indicative of money laundering or other violations of law, a fact recognized both by Congress, in authorizing reform of the currency transaction reporting system, and by us, in issuing rules to implement that system (see 31 U.S.C. 5313(d) and 31 CFR § 103.22(d), 63 FR 50147 (Sept. 21, 1998)). Many non-currency transactions (for example, transmittals of funds) *can* indicate illicit activity, especially in light of the breadth of the statutes that make money laundering a crime. See 18 U.S.C. 1956 and 1957.

The obligation extends to transactions conducted or attempted by, at, or through, the mutual fund. However, section 103.15(a) also contains language designed to encourage the reporting of transactions that appear relevant to violations of law or regulation, even in cases in which the rule does not explicitly so require (for example, in the case of a transaction falling below the \$5,000 threshold in the rule).

Section 103.15(a) contains the general statement regarding a mutual fund's obligation to file reports of suspicious transactions with us. To clarify that the final rule creates a reporting requirement that is uniform with that for other financial institutions, section 103.15(a)(1), which is unchanged from the proposed rule, incorporates language from the suspicious activity reporting rules applicable to other financial institutions, such as banks, broker-dealers, casinos, and money services businesses, requiring the reporting of "any suspicious transaction relevant to a possible violation of law or regulation." Further, a mutual fund may also report "any suspicious transaction that it believes is relevant to a possible violation of any law or regulation but whose reporting is not required" by the final rule. For example, a mutual fund may report a suspected violation of law that involves less than \$5,000. Such voluntary reporting would be subject to the same protection from liability as mandatory reporting pursuant to 31 U.S.C. 5318(g)(3).

The final rule requires reporting by mutual funds, but not by affiliated persons of mutual funds. This approach is consistent with our other rules requiring the reporting of suspicious activity.

Mutual funds typically conduct many operations through separate entities, which may or may not be affiliated persons of the mutual fund. These separate entities include investment advisers, principal underwriters, administrators, custodians, transfer agents,

and other service providers. Personnel of these separate entities may be in the best position to perform the reporting obligation, and a mutual fund may contract with an affiliated or unaffiliated service provider to perform the reporting obligation as the fund's agent. In such cases, however, the mutual fund remains responsible for assuring compliance with the rule, and therefore must actively monitor the performance of its reporting obligations.²² The fund should take steps to assure that the service provider has implemented effective compliance policies and procedures administered by competent personnel, and should maintain an active working relationship with the service provider's compliance personnel.²³

Section 103.15(a)(2), which is also unchanged from the Proposed Rule, requires the reporting of suspicious activity that involves or aggregates at least \$5,000 in funds or other assets. The suspicious activity reporting rules, however, are not intended to operate (and indeed cannot properly operate) in a mechanical fashion. Rather, such requirements are intended to function in such a way as to have financial institutions evaluate customer activity and relationships for money laundering risks.²⁴

Section 103.15(a)(2) specifies four categories of transactions that require reporting if the mutual fund knows, suspects, or has reason to suspect that any such category applies to a transaction, or a pattern of transactions of which the transaction is a

²² Under 17 CFR 270.38a-1, each mutual fund must appoint a chief compliance officer, reporting directly to the mutual fund's board of directors, to administer its compliance policies and procedures. *See* 68 FR 74714 (Dec. 24, 2003).

²³ For a discussion of the oversight responsibilities of mutual funds over their service providers, *see* Compliance Programs of Investment Companies and Investment Advisers, *supra* note 22, nn.91-92 and accompanying text.

²⁴ For example, transactions involving investments by the pension fund of a publicly traded corporation, even though involving a large dollar amount, would likely require more limited scrutiny than less typical transactions, such as those involving customers who wish to use currency or money orders to purchase mutual fund shares, even though the dollar amounts in those latter cases may be relatively small.

part. The “knows, suspects, or has reason to suspect” standard incorporates a concept of due diligence into the reporting requirement.

The first category, described in section 103.15(a)(2)(i), includes transactions involving funds derived from illegal activity, or intended or conducted in order to hide or disguise funds derived from such illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation. The second category, described in section 103.15(a)(2)(ii), includes transactions designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act. The third category, described in section 103.15(a)(2)(iii), includes transactions that appear to serve no business or apparent lawful purposes, and for which the mutual fund knows of no reasonable explanation after examining the available facts relating to the transaction and the parties. The fourth category, described in section 103.15(a)(2)(iv), includes any other transactions that involve the use of the mutual fund to facilitate criminal activity.²⁵

In determining whether to file a Suspicious Activity Report, a mutual fund must base the determination on all of the facts and circumstances relating to the transaction and the customer in question.²⁶ Different fact patterns will require different types of

²⁵ The fourth reporting category has been added to the suspicious activity reporting rules promulgated since the passage of the USA PATRIOT Act to make it clear that the requirement to report suspicious activity encompasses the reporting of transactions in which legally derived funds are used for criminal activity, such as the financing of terrorism.

²⁶ In the case of a transaction conducted through an omnibus account maintained by an intermediary, a mutual fund may not know, suspect, or have reason to suspect that the transaction is one for which reporting would be required, because a fund typically has little or no information about individual customers of the intermediary. An omnibus account is usually maintained by another financial institution, such as a broker-dealer, that has a reporting obligation with regard to its customers. The omnibus account holder (*i.e.*, the financial institution intermediary) is a customer of the mutual fund for purposes of the final rule. An omnibus account maintained for a foreign financial institution would be considered a correspondent account under section 312 of the USA PATRIOT Act, and as such, is subject to due diligence and possibly enhanced due diligence requirements under that section of the Act and implementing

judgments. In some cases, the facts of the transaction may indicate the need to file a Suspicious Activity Report. For example, if a mutual fund closes the account and redeems the shares of a customer whose identity the fund is unable to verify under its customer identification program,²⁷ the fund should consider whether the circumstances surrounding its failure to verify would warrant the filing of a Suspicious Activity Report. In these and other situations, the fact that a customer refuses to provide information necessary for the mutual fund to verify the customer's identity, make reports, or keep records required by this part or other regulations, provides information that the mutual fund determines to be false, or seeks to change or cancel a transaction after such person is informed of information verification or recordkeeping requirements relevant to the transactions, would indicate the probability that a Suspicious Activity Report should be filed.²⁸ In other situations, determining whether a transaction is suspicious within the meaning of the rule may require more involved judgment. Transactions that raise the need for such judgment may include, for example: (1) transmission or receipt of funds transfers without normal identifying information, or in a manner that may indicate an attempt to disguise or hide the country of origin or destination, or the identity of the customer sending the funds, or the beneficiary to which the funds are sent; or (2) repeated use of a mutual fund as a temporary resting place for funds from multiple sources without a clear business (including investment) purpose. The judgments involved will also extend to whether the facts and circumstances and the institution's knowledge of its

regulations. See Anti-Money Laundering Programs; Special Due Diligence for Certain Foreign Accounts, 71 FR 496 (Final Rule) and 71 FR 516 (Notice of Proposed Rulemaking) (January 4, 2006).

²⁷ See *supra* note 9 and accompanying text.

²⁸ As section 103.15(d) of the final rule makes clear, the mutual fund must not notify the customer that it intends to file or has filed a Suspicious Activity Report with respect to the customer's activity.

customer provide a reasonable explanation for the transaction that removes it from the suspicious category.²⁹

The means of commerce and the techniques of money launderers are continually evolving, and it is not possible to provide an exhaustive list of suspicious transactions. We intend to continue our dialogue with the mutual fund industry about the manner in which a combination of government guidance, training programs, and government-industry information exchange can facilitate operation of the new suspicious activity reporting system in as flexible and cost-efficient a way as possible.

Individual mutual funds are frequently part of a complex of related funds, and it is possible that more than one mutual fund would be obligated to report the same transaction or transactions. In order to clarify the permissibility of joint reports, section 103.15(a)(3) of the final rule has been revised to permit all of the mutual funds involved in a particular transaction to file a single joint report. Because the Suspicious Activity Report by Securities and Futures Industries (“Form SAR-SF”) accommodates the name of only one filer, only one of the filing institutions should be identified as the “filer” in the filer identification section of the form.³⁰ The narrative section of the Form SAR-SF must include the words “joint filing” and identify the other mutual funds on whose behalf the report is being filed. The joint report must contain all relevant facts, and each mutual

²⁹ One commenter expressed concern that a mutual fund would be expected to obtain additional information that it does not already have to meet the “knows, suspects, or has reason to suspect” standard of section 103.15(a)(2). We expect funds to determine whether to file a Suspicious Activity Report based on the information obtained in the account opening process or subsequently in the course of processing transactions.

³⁰ The term “SF” is an abbreviation for “Securities and Futures Industries,” the form that is used for reporting by members of the securities and futures industries. See 67 FR 50751 (Aug. 5, 2002). The form became final on December 26, 2002, and is available on our website at http://www.fincen.gov/reg_bsaforms.html.

fund must maintain a copy of the joint report, along with any supporting documentation.³¹

A service provider who performs reporting obligations under contract with multiple mutual funds may file a single joint report on behalf of all of the funds involved in a transaction or series of transactions.³²

Further, section 103.15(a)(3) of the final rule has been revised to also recognize that other financial institutions, such as broker-dealers in securities, may have separate obligations to report the same suspicious activity under other Bank Secrecy Act regulations.³³ In those instances, it is permissible for either a mutual fund or the other financial institution to file a single joint report on behalf of all of the mutual fund(s) and other financial institution(s) involved in the transaction. As with a joint report filed by a mutual fund on behalf of other mutual funds, the joint report filed must contain all relevant facts, and the narrative of the Form SAR-SF must include the words “joint filing” and must identify the other financial institutions on whose behalf the report is being filed.

One commenter requested that this final rule clarify that it will not impose a duplicative reporting requirement on insurance companies, because a single transaction may create a reporting requirement for both an insurance company, under the rule applicable to insurance companies,³⁴ and for a separate account of the insurance company that issues variable insurance products, under this rule. Because this rule applies only to open-end management investment companies, it does not apply to separate accounts that

³¹ The filer should not submit supporting documentation with the Form SAR-SF. *See infra* note 38 and accompanying text.

³² *See supra* note 22 and accompanying text.

³³ *See* 31 CFR § 103.19.

³⁴ *See* 31 CFR § 103.16.

are organized as unit investment trusts, which comprise a majority of the separate accounts that issue variable insurance products. Accordingly, the rule applies only to a separate account that is organized as a managed separate account. To avoid the possibility of duplicative suspicious activity reporting, we are contemporaneously amending the rule applicable to insurance companies to require an insurance company that issues variable insurance products funded by separate accounts that meet the definition of a mutual fund to report suspicious activity pursuant to this final rule.³⁵ In addition, a registered broker-dealer involved in a suspicious transaction may file a joint report on behalf of any separate account under section 103.15(a)(3).

When a mutual fund or other financial institution files or considers filing a joint report on behalf of other mutual funds, it typically will exchange information with the other entities to determine whether the transaction must be reported under this section, and, if so, to determine which party should file the report, provide the filer with comprehensive information and supporting documentation, and provide confirmation of the filing to each mutual fund (and other financial institution) involved in the transaction. Prior to filing a joint report, a mutual fund may share information pertaining to a suspicious transaction with any other financial institution or service provider involved in the transaction, provided that such financial institution or service provider will not be the subject of the report. Such sharing of information does not violate the non-disclosure provisions of section 103.15(d).³⁶ If a service provider is performing the reporting obligations of one or more mutual funds under contract with the fund(s), the service

³⁵ See 31 CFR § 103.16(b)(3)(iii).

³⁶ See Section III.D. *infra*.

provider may similarly share the information as an agent of the mutual fund(s).³⁷

However, after the report is filed, further disclosure of the fact that a suspicious activity report was filed is prohibited, except as permitted by section 103.15(d). The cross-reference in section 103.15(d) to section 103.15(a)(3) in the Proposed Rule remains in the final rule.

B. 103.15(b) – Filing Procedures

Section 103.15(b), unchanged from the proposed rule except as noted in footnote 39 below, directs mutual funds to report suspicious activities by completing a Form SAR-SF, and sets forth the filing procedures to be followed by mutual funds making reports of suspicious activity. Within 30 days after initial detection of a suspicious activity by a mutual fund, the fund must report the transaction by completing a Form SAR-SF, collecting and maintaining supporting documentation, and filing the form as indicated in the instructions to the form. The filer should not submit the supporting documentation with the Form SAR-SF. Form SAR-SF is the same form used by broker-dealers, futures commission merchants, and introducing brokers in commodities.³⁸ If a separate entity that is not a financial institution files a Form SAR-SF as agent for a mutual fund, that entity should designate the mutual fund as the reporting financial institution on the Form SAR-SF.

If the mutual fund does not identify a suspect on the date of the initial detection, it may delay filing a Form SAR-SF for 30 days, but may not delay filing more than 60 days after the date of such initial detection. In situations involving violations that require

³⁷ For a discussion of the types of service providers that may perform reporting obligations under contract with mutual funds, *see supra* note 22 and accompanying text.

³⁸ *See* 67 FR 70808 (Nov. 26, 2002) (effective Jan. 1, 2003).

immediate attention, such as suspected terrorist financing or ongoing money laundering schemes, a mutual fund must notify an appropriate law enforcement authority by telephone in addition to filing a Form SAR-SF.³⁹ A mutual fund may also, but is not required to, contact the Commission in such situations. A mutual fund that chooses to contact the Commission should contact its Office of Compliance Inspections and Examinations. In addition, we wish to remind mutual funds of our Financial Institutions Hotline (1-866-556-3974), which financial institutions may use to voluntarily report suspicious activity that may relate to terrorist financing. Mutual funds that report suspicious activity by calling the Financial Institutions Hotline must also file a timely Form SAR-SF to the extent required by this final rule.

C. 103.15(c) – Retention of Records

Section 103.15(c) requires that a mutual fund maintain copies of Suspicious Activity Reports that it files or that are filed on its behalf (including joint reports), and the original (or business record equivalent) and copies of related documentation, for a period of five years from the date of filing. The final rule has been modified to include references to reports filed on behalf of the fund (*e.g.*, by a service provider) and joint reports (whether filed by the fund or by another financial institution naming the fund). The Suspicious Activity Report and the supporting documentation are to be made available to the Financial Crimes Enforcement Network, the Commission, and other appropriate law enforcement and regulatory authorities. The final rule also has been modified to add a self-regulatory organization registered with the Commission in those cases where a mutual fund maintains supporting documentation concerning a joint

³⁹ The final rule has been revised to make such notification mandatory, to be consistent with the reporting rules for other financial institutions. *See, e.g.*, 31 CFR §§ 103.18(b)(3), 103.19(b)(3), and 103.16(c)(3).

Suspicious Activity Report involving a broker-dealer being examined pursuant to 31 CFR § 103.19(g).

D. 103.15(d) – Confidentiality of Reports

Section 103.15(d) reflects the statutory prohibition against the disclosure of information filed in, or the fact of filing, a Suspicious Activity Report, except to the extent permitted by paragraph (a)(3). The final rule has been revised to clarify that the prohibition applies whether the report is required by the final rule or is filed voluntarily. *See* 31 U.S.C. 5318(g)(2). Section 103.15(d) extends the prohibition to any mutual fund subpoenaed or otherwise required to disclose a Suspicious Activity Report or information contained in a Form SAR-SF. Thus, section 103.15(d) specifically prohibits persons filing Suspicious Activity Reports (including persons on whose behalf a report has been filed) from disclosing, except to the Financial Crimes Enforcement Network, the Commission, or another appropriate law enforcement or regulatory agency, or a self-regulatory organization registered with the Securities and Exchange Commission conducting an examination of a broker-dealer pursuant to 31 CFR § 103.19(g), that a Suspicious Activity Report has been filed or from providing any information that would disclose that a report has been prepared or filed. The final rule has been modified to note that the prohibition also applies to joint reports.

Section 103.15(d) does not prohibit a mutual fund from engaging in discussions with any other financial institution or service provider involved in the transaction, other than the person who is or is expected to be the subject of the report, to determine whether the transaction must be reported under this section; to determine which party will file the report, provide the filer with comprehensive information and supporting documentation;

and to provide confirmation of the filing to each mutual fund involved in the transaction.⁴⁰ Similarly, this provision does not prohibit a service provider who performs reporting obligations under contract with one or more mutual funds from sharing information as an agent of the mutual fund(s). In addition, we have issued regulations under section 314(b) of the USA PATRIOT Act to permit certain financial institutions, after providing notice to us, to share information with one another solely for the purpose of identifying and reporting to the federal government activities that may involve money laundering or terrorist activity.⁴¹ Neither section 314(b) nor its implementing regulations, however, apply to the sharing of a Suspicious Activity Report with another financial institution. However, as described in Sections III.A. and III.C., a Suspicious Activity Report may be shared between financial institutions for the purposes of jointly filing and maintaining a record of such a report.

E. 103.15(e) – Limitation of Liability

Section 103.15(e) restates the broad statutory protection from liability for making reports of suspicious activity and for failure to disclose the fact of such reporting, whether the report is required by the final rule or is filed voluntarily. As amended by section 351 of the USA PATRIOT Act, 31 U.S.C. 5318(g)(3) provides a safe harbor from liability to any financial institution that makes a voluntary disclosure of any possible violation of law or regulation to a government agency, and to any financial institution that reports suspicious activity pursuant to section 5318(g) or pursuant to any other authority. Section 5318(g)(3) provides further protection from liability for the non-disclosure of the fact of such reporting. We note that the safe harbor extends to agents of

⁴⁰ See 31 CFR § 103.15(a)(3).

⁴¹ See 31 CFR § 103.110.

the mutual fund filing reports, including transfer agents and other service providers. The final rule was modified to state the safe harbor in terms of a protection from liability and to include joint reports within the safe harbor.

F. 103.15(f) – Examinations and Enforcement

Section 103.15(f), which is unchanged from the proposed rule, provides that the Department of the Treasury, through the Financial Crimes Enforcement Network or its delegates, will examine compliance with the obligation to report suspicious activity, and that failure to comply with the rule may constitute a violation of the Bank Secrecy Act and the Bank Secrecy Act regulations. The Department of the Treasury has delegated to the Commission its authority to examine mutual funds for compliance.⁴² In reviewing any particular failure to report a transaction as required by this section, the Financial Crimes Enforcement Network and the Commission may take into account the relationship between the particular failure to report and the adequacy of the implementation and operation of a mutual fund's compliance procedures.

G. 103.15(g) – Effective Date

Section 103.15(g) provides that the rule applies to transactions occurring after [INSERT DATE THAT IS 180 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

IV. Regulatory Flexibility Act

It is hereby certified that this final regulation will not have a significant economic impact on a substantial number of small entities. Registered investment companies, regardless of their size, are currently subject to the Bank Secrecy Act. Procedures

⁴² See 31 CFR § 103.56(b)(6) (delegating authority to examine investment companies to the Commission).

currently in place at mutual funds to comply with existing Bank Secrecy Act rules should help mutual funds to identify suspicious activity and small mutual funds may have an established and limited customer base whose transactions are well known to the fund. Moreover, as indicated below in Section VI, the estimated burden associated with reporting suspicious transactions is minimal.

V. Executive Order 12866

The Department of the Treasury has determined that this final regulation is not a significant regulatory action under Executive Order 12866.

VI. Paperwork Reduction Act

The collection of information contained in this final regulation has been approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1506-0019. The estimated average burden associated with the collection of information in this final rule is four hours per respondent. We received no comment on its recordkeeping burden estimate.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 (or by the electronic mail to ahunt@eop.omb.gov).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

List of Subjects in 31 CFR Part 103

Administrative practice and procedure, Authority delegations (Government agencies), Securities, Currency, Investigations, Law enforcement, Reporting and recordkeeping requirements.

Amendments to the Regulations

For the reasons set forth above in the preamble, 31 CFR Part 103 is amended as follows:

PART 103 – Financial Recordkeeping and Reporting of Currency and Foreign Transactions

1. The authority citation for Part 103 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

2. In Subpart B, § 103.15 is redesignated as § 103.12.
3. In Subpart B, § 103.15 is added to read as follows:

§ 103.15 Reports by mutual funds of suspicious transactions.

(a) *General.* (1) Every investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) (“Investment Company Act”) that is an open-end company (as defined in section 5 of the Investment Company Act (15 U.S.C. 80a-5)) and that is registered, or is required to register, with the Securities and Exchange Commission pursuant to that Act (for purposes of this section, a “mutual fund”), shall file with the Financial Crimes Enforcement Network, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation. A mutual fund may also file with the Financial Crimes Enforcement

Network a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation, but whose reporting is not required by this section.

Filing a report of a suspicious transaction does not relieve a mutual fund from the responsibility of complying with any other reporting requirements imposed by the Securities and Exchange Commission.

(2) A transaction requires reporting under this section if it is conducted or attempted by, at, or through a mutual fund, it involves or aggregates funds or other assets of at least \$5,000, and the mutual fund knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):

(i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

(ii) Is designed, whether through structuring or other means, to evade any requirements of this part or any other regulations promulgated under the Bank Secrecy Act, Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314, 5316-5332;

(iii) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the mutual fund knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or

(iv) Involves use of the mutual fund to facilitate criminal activity.

(3) More than one mutual fund may have an obligation to report the same transaction under this section, and other financial institutions may have separate obligations to report suspicious activity with respect to the same transaction pursuant to other provisions of this part. In those instances, no more than one report is required to be filed by the mutual fund(s) and other financial institution(s) involved in the transaction, provided that the report filed contains all relevant facts, including the name of each financial institution and the words “joint filing” in the narrative section, and each institution maintains a copy of the report filed, along with any supporting documentation.

(b) *Filing and notification procedures* – (1) *What to file.* A suspicious transaction shall be reported by completing a Suspicious Activity Report by Securities and Futures Industries (“SAR-SF”), and collecting and maintaining supporting documentation as required by paragraph (c) of this section.

(2) *Where to file.* Form SAR-SF shall be filed with the Financial Crimes Enforcement Network in accordance with the instructions to the Form SAR-SF.

(3) *When to file.* A Form SAR-SF shall be filed no later than 30 calendar days after the date of the initial detection by the reporting mutual fund of facts that may constitute a basis for filing a Form SAR-SF under this section. If no suspect is identified on the date of such initial detection, a mutual fund may delay filing a Form SAR-SF for an additional 30 calendar days to identify a suspect, but in no case shall reporting be delayed more than 60 calendar days after the date of such initial detection.

(4) *Mandatory notification to law enforcement.* In situations involving violations that require immediate attention, such as suspected terrorist financing or ongoing money

laundering schemes, a mutual fund shall immediately notify by telephone an appropriate law enforcement authority in addition to filing timely a Form SAR-SF.

(5) *Voluntary notification to the Financial Crimes Enforcement Network or the Securities and Exchange Commission.* Mutual funds wishing voluntarily to report suspicious transactions that may relate to terrorist activity may call the Financial Crimes Enforcement Network's Financial Institutions Hotline at 1-866-556-3974 in addition to filing timely a Form SAR-SF if required by this section. The mutual fund may also, but is not required to, contact the Securities and Exchange Commission to report in such situations.

(c) *Retention of records.* A mutual fund shall maintain a copy of any Form SAR-SF filed by the fund or on its behalf (including joint reports), and the original (or business record equivalent) of any supporting documentation concerning any Form SAR-SF that it files (or is filed on its behalf), for a period of five years from the date of filing the Form SAR-SF. Supporting documentation shall be identified as such and maintained by the mutual fund, and shall be deemed to have been filed with the Form SAR-SF. The mutual fund shall make all supporting documentation available to the Financial Crimes Enforcement Network, any other appropriate law enforcement agencies or federal or state securities regulators, and for purposes of an examination of a broker-dealer pursuant to § 103.19(g) regarding a joint report, to a self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(26)) registered with the Securities and Exchange Commission, upon request.

(d) *Confidentiality of reports.* No mutual fund, and no director, officer, employee, or agent of any mutual fund, who reports a suspicious transaction under this

part (whether such a report is required by this section or made voluntarily), may notify any person involved in the transaction that the transaction has been reported, except to the extent permitted by paragraph (a)(3) of this section. Any person subpoenaed or otherwise required to disclose a Form SAR-SF or the information contained in a Form SAR-SF, including a Form SAR-SF filed jointly with another financial institution involved in the same transaction (except where such disclosure is requested by the Financial Crimes Enforcement Network, the Securities and Exchange Commission, another appropriate law enforcement or regulatory agency, or, in the case of a joint report involving a broker-dealer, a self-regulatory organization registered with the Securities and Exchange Commission conducting an examination of such broker-dealer pursuant to § 103.19(g)), shall decline to produce Form SAR-SF or to provide any information that would disclose that a Form SAR-SF has been prepared or filed, citing this paragraph (d) and 31 U.S.C. 5318(g)(2), and shall notify the Financial Crimes Enforcement Network of any such request and its response thereto.

(e) *Limitation of liability.* A mutual fund, and any director, officer, employee, or agent of such mutual fund, that makes a report of any possible violation of law or regulation pursuant to this section, including a joint report (whether such report is required by this section or made voluntarily) shall be protected from liability for any disclosure contained in, or for failure to disclose the fact of, such report, or both, to the extent provided in 31 U.S.C. 5318(g)(3).

(f) *Examinations and enforcement.* Compliance with this section shall be examined by the Department of the Treasury, through the Financial Crimes Enforcement Network or its delegees, under the terms of the Bank Secrecy Act. Failure to satisfy the

requirements of this section may constitute a violation of the reporting rules of the Bank Secrecy Act and of this part.

(g) *Effective date.* This section applies to transactions occurring after [INSERT DATE THAT IS 180 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

4. In Subpart B, add § 103.16(b)(3)(iii) to read as follows:

§ 103.16 Reports by insurance companies of suspicious transactions.

* * * * *

(b) * * *

(3) * * *

(iii) An insurance company that issues variable insurance products funded by separate accounts that meet the definition of a mutual fund in § 103.15(a)(1) shall file reports of suspicious transactions pursuant to § 103.15.

Dated: April 27, 2006

Robert W. Werner

Robert W. Werner

Director

Financial Crimes Enforcement Network